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In the Supreme Court of the United States

OCTOBER TERM, 1982

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

BOARD OF TRADE OF THE CITY OF CHICAGO AND CHICAGO BOARD OPTIONS EXCHANGE, INC.

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

BOARD OF TRADE OF THE CITY OF CHICAGO, CHICAGO BOARD OPTIONS EXCHANGE, INC., AND THE OPTIONS CLEARING CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether standardized options to buy and sell securities are "securities," as defined in Section 3(a)(10) of the Securities Exchange Act of 1934.

2. Whether the Commodity Futures Trading Commission has exclusive jurisdiction to regulate trading in options on securities that are the subject of futures trading.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the Securities and Exchange Commission, petitions for a writ of certiorari to review the judgments of the United States Court of Appeals for the Seventh Circuit in these cases. See Rule 19.4 of the Rules of this Court.

OPINIONS BELOW

The opinion of the court of appeals in No. 81-1660 (Pet. App. A-1 to A-99) is reported at 677 F.2d 1137.[1] The order of the Securities and Exchange Commission (Pet. App. C-1 to C-15) is reported at 46 Fed. Reg. 15241 (1981).

[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in *Chicago Board Options Exchange, Incorporated* and *The Options Clearing Corporation* v. *Board of Trade of the City of Chicago*, No. 82-327, which also seeks review of the decisions in these cases.

The opinion of the court of appeals in No. 81-2587 (Pet. App. B-1 to B-5) is not reported. The order of the Securities and Exchange Commission (Pet. App. D-1 to D-12) is reported at 46 Fed. Reg. 40849 (1981).

JURISDICTION

The judgments of the court of appeals were entered on March 24, 1982 (Pet. App. E-1, F-1). Petitions for rehearing in both cases were denied on May 27, 1982 (Pet. App. G-1). On August 16, 1982, Justice Stevens extended the time for filing the petition for a writ of certiorari in both cases to and including September 24, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The pertinent provisions of the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) and the Commodity Exchange Act (7 U.S.C. (& Supp. IV) 1 *et seq.*) are set out at Pet. App. H-1 to H-14.

STATEMENT

1. The Chicago Board Options Exchange Inc. (CBOE) was established in 1973 and is registered as a national securities exchange under Section 6 of the Securities Exchange Act of 1934, 15 U.S.C. 78f. CBOE provides a market for trading put and call options on securities.[2] The Options Clearing Corporation (OCC) is a registered clearing agency under Section 17A of the Securities Ex-

[2] A call option gives the holder the right to purchase a specific quantity of the underlying security from the writer of the options contract at a specified price during the life of the option. A put option similarly gives the holder the right to sell a specific quantity of the underlying security to the writer of the options contract. The purchaser of either a put or call option is said to be "long" the option, and the option writer is said to be "short" the option. See generally *Report of the Special Study of the Options Markets to the* SEC 73-75 (Comm. Print 96-IFC3 1978).

change Act, 15 U.S.C. 78q-1, and is the clearing agency for all exchange traded options.[3]

Changes in the rules of a registered securities exchange and a registered securities clearing agency must be submitted to the Securities and Exchange Commission for approval. See 15 U.S.C. 78s(b) and 78c(a)(26). CBOE proposed changes in its rules to permit trading in standardized options on mortgage-backed debt securities guaranteed by the Government National Mortgage Association (GNMA). Pet. App. C-1.[4] OCC proposed related rule changes under which it would (1) issue options on GNMA securities, (2) clear and settle GNMA options transactions, and (3) process and settle exercises of GNMA options. Pet. App. D-1. The SEC found both proposals consistent with the applicable requirements of the Securities Exchange Act. In separate orders, the SEC therefore approved the rule changes. Pet. App. C-1 to C-15 (CBOE proposal); *id.* at D-1 to D-12 (OCC proposal).

The Board of Trade of the City of Chicago (CBOT) petitioned for review of the SEC orders in the United States Court of Appeals for the Seventh Circuit. A divided panel of that court set aside both orders on identical grounds. Pet. App. A-1 to A-99; *id.* at B-1 to B-5. In an opinion by Chief Judge Cummings, the majority held (Pet. App. A-37 to A-46) that an option on a secu-

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[3] A "clearing agency" is an intermediary for securities transactions and may provide facilities for settlement of securities transactions. See 15 U.S.C. 78c(a)(23).

[4] Like options on equity securities, currently traded on CBOE and on three other national securities exchanges, the proposed GNMA options would be standardized as to exercise price, contract size, and expiration date. Although each options transaction (involving either a put or a call) on the CBOE floor requires the participation of both a buyer and a writer, the initial privity between the buyer and writer is severed and OCC is substituted as the issuer of the options contract. As a result, OCC assumes all contractual obligations. The initial purchasers and writers, in turn, are obligated to OCC. Most equity options are terminated by a closing (*i.e.*, offsetting) transaction, and therefore do not result in delivery of the underlying security.

rity is not a "security" within the meaning of Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10). The court concluded, therefore, that the SEC lacks authority to regulate trading in such instruments except under Section 9(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78i(b)), which applies to trading in options on non-exempted securities on national securities exchanges. In the majority's view, the phrase "warrants or rights to subscribe to or purchase" a security contained in the statute's definition of the term "security" refers to only particular kinds of options, and does not encompass the options contemplated by the CBOE and OCC proposals. *Id.* at A-39 to A-40. In any event, the court explained (*id.* at A-41), the phrase "warrants or rights to * * * purchase" a security could only include options to purchase securities, while the CBOE and OCC proposals contemplated trading in both options to purchase and options to sell. The majority also concluded (Pet. App. A-42 to A-44) that the proposed options were neither "investment contract[s]" nor "instrument[s] commonly known as * * * 'securit[ies]'" because options purchasers do not invest in a "common enterprise."

Alternatively, the majority held (Pet. App. A-17 to A-36) that trading in options on GNMA securities is within the exclusive jurisdiction of the Commodity Futures Trading Commission and, therefore, unlawful under Section 4c of the Commodity Exchange Act, 7 U.S.C. (Supp. IV) 6c. Because GNMA securities are the subject of futures trading on CBOT, a GNMA security is a "commodity" as defined in Section 2(a)(1) of the Commodity Exchange Act, 7 U.S.C. (Supp. IV) 2. Pet. App. A-10 to A-11. The CFTC has exclusive jurisdiction over options "involving" commodity futures contracts. 7 U.S.C. (Supp. IV) 2. According to the court of appeals (Pet. App. A-32): "Since GNMA [securities] are not traditional stocks and GNMA options have the character of a legitimate commodity derivative, * * * the proposed GNMA options 'involve' the pre-existing GNMA futures and

therefore are within the exclusive jurisdiction of the CFTC."

Finally, the court of appeals rejected (Pet. App. A-34 to A-36) the argument that the "Treasury exclusion" contained in the Commodity Exchange Act makes the Act inapplicable to trading in GNMA options. Under that provision, the Commodity Exchange Act is inapplicable to "transactions in * * * security warrants, security rights, * * * [and] government securities * * *, unless such transactions involve the sale thereof for future delivery conducted on a board of trade" (7 U.S.C. (Supp. IV) 2). According to the majority (Pet. App. A-35), the term "security rights" contained in this provision might be construed to encompass options to purchase securities. Nonetheless, the court concluded (Pet. App. A-36) that the Commodity Exchange Act is applicable to trading in options on GNMA securities because "GNMA options 'involve' GNMA futures."

Judge Cudahy dissented (Pet. App. A-66 to A-99), rejecting the majority's conclusion that the proposed GNMA options are not securities (Pet. App. A-90 to A-95), as well as its conclusion that GNMA options are within the CFTC's exclusive jurisdiction (Pet. App. A-66 to A-88). In Judge Cudahy's view (Pet. App. A-66) the "opinion for the majority fails at almost every turn to meet the tests of plain language, congressional intent, historical context and practical result."

REASONS FOR GRANTING THE PETITION

Standardized options on equity securities issued by OCC are now listed and traded on four national securities exchanges, including CBOE which lists only options. Because SEC regulation of listed options trading is based on the premise that all options are separate securities, the court of appeals' holding to the contrary threatens serious disruption of those markets. Section 2 of the Securities Exchange Act of 1934, 15 U.S.C. 78b, charges the SEC with responsibility to provide for the regulation and control of "transactions in securities as commonly conducted upon securities exchanges * * * and

to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, * * * and to insure the maintenance of fair and honest markets in such transactions." SEC regulation of exchange-traded standardized options is critical to the fair and orderly operation of the options markets and to the protection of investors and the public interest. The court of appeals' decision threatens serious disruption of the SEC's long-standing regulation of options trading.

Since its inception in 1973, exchange trading in standardized options on securities has flourished. Notwithstanding a three-year moratorium on expansion of exchange trading in options, the market value of the 96.8 million options contracts traded in 1980 was $45.8 billion. 47th SEC Ann. Rep. 4, 130-131 & Table 22 (1981); see also *Report of the Special Study of the Options Markets to the SEC* 76 (Comm. Print 96-IFC3 1978). Exchange-traded standardized options on securities provide an alternative to short term stock trading and a means of shifting the risks of adverse movements in the price of the underlying securities. *Id.* at 1, 82-90. Similarly, options on GNMA securities or on any other interest-sensitive debt security would offer opportunities to hedge against fluctuations in interest rates. Trading in GNMA options, therefore, is expected to be of substantial practical importance to the nation's financial markets.

Aside from the economic significance and regulatory implications of these cases, they raise a serious question of federal law concerning whether Congress intended to place regulatory authority over GNMA options in the SEC or the CFTC. While these cases were pending in the Seventh Circuit, the SEC and the CFTC reached agreement as to the scope of their respective jurisdictions, and proposed legislation to Congress which would clarify the SEC's authority to regulate options on debt securities such as GNMA securities.[5] In the absence of legislative

[5] Legislation to implement the agencies' agreement was introduced and has now been favorably reported by the appropriate committees.

action, the agencies and the public must look to the courts for final resolution of conflicting statutory interpretations of existing laws. (See Pet. App. A-64 to A-65.)

1.*a.* This Court repeatedly has emphasized that the language of the statute is the starting point. See, *e.g.*, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976). As used in the Securities Exchange Act of 1934, unless "the context otherwise requires" (15 U.S.C. 78c(a)(10), emphasis added):

> The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, *or in general, any instrument commonly known as a "security"*; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, *or warrant or right to subscribe to or purchase*, any of the foregoing * * *.

The GNMA options proposed to be traded on the CBOE are, by virtue of well-established commercial practice, "instrument[s] commonly known as 'securit[ies].'"[6]

See H.R. Rep. No. 97-626, 97th Cong., 2d Sess. (1982); H.R. Rep. No. 97-565, 97th Cong., 2d Sess. (1982); S. Rep. No. 97-390, 97th Cong., 2d Sess. (1982); S. Rep. No. 97-384, 97th Cong., 2d Sess. (1982). The House of Representatives passed the legislation (H.R. 6156, 97th Cong., 2d Sess.; H.R. 5447, 97th Cong., 2d Sess.) on September 23, 1982.

[6] In addition, as the court of appeals appears to acknowledge (Pet. App. A-40 to A-41), the phrase "warrant or right to subscribe to or purchase" a security in the definition of security in Section 3(a)(10) of the Securities Exchange Act literally encompasses GNMA "call" options. See *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1026 n.40 (6th Cir. 1979); 1 L. Loss, *Securities Regulation* 469 (2d ed. 1961).

Contrary to the apparent assumption of the court of appeals (see Pet. App. A-41; see also *id.* A-35), there is no necessary relationship between trading in options to buy securities ("call" options) and

The phrase "instrument commonly known as a 'security' " does not limit the scope of the other phrases in the definition. *Tcherepnin* v. *Knight*, 389 U.S. 332, 343 (1967). Nor is that general phrase limited by any of the more specific phrases in the definition. *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350 (1943); see *Tcherepnin* v. *Knight*, *supra*, 389 U.S. at 343. The comprehensive language used by Congress in defining the term "security" demonstrates that it "intended the securities laws to cover those instruments ordinarily and commonly considered to be securities in the commercial world * * *." *Marine Bank* v. *Weaver*, No. 80-1562 (Mar. 8, 1982), slip op. 8; see *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 847-848 (1975).[7]

b. In the commercial world, listed options on equity securities are recognized as separate securities by participants in all of the various facets of the securities industry. CBOE, which provides a market for standardized options exclusively, is registered as a national securities exchange. See 15 U.S.C. 78c(a)(1). The American

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trading in options to sell securities ("put" options). The court of appeals suggests that purchasing a put option will close out a long position in a call option and purchasing a call option will close out a long position in a put option. The court states (Pet. App. A-41) that " 'warrants or rights' would cover only options to purchase ('call' options) and the CBOE off-set program requires the complementary trading of options to sell ('put' options)." Puts and calls, however, are completely independent. A long call position offsets a short call position and a long put position offsets a short put position. In fact, call options were traded on four national securities exchanges for over seven years without corresponding put options trading on most of the underlying issues.

[7] Nothing in either *Teamsters* v. *Daniel*, 439 U.S. 551, 558 n.11 (1979), or *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 852 (1975), conflicts with these general principles. Contrary to the apparent conclusion of the court of appeals (Pet. App. A-43 to A-44), the phrases "investment contract" and "instrument commonly known as a 'security' " are not coextensive. Nor is there any reason for reading the latter phrase out of the definition by holding that it includes only interests or instruments also covered by one or more of the other elements of the definition.

Stock Exchange (Amex), the Pacific Stock Exchange (PSE), and the Philadelphia Stock Exchange (Phlx) all provide markets for standardized options pursuant to SEC rules governing securities trading. 47th SEC Ann. Rep., *supra*, at 131 (Table 22). The New York Stock Exchange (NYSE) proposes to list and permit trading in options on both GNMA securities and United States Treasury securities. 47th SEC Ann. Rep., *supra*, at 5. Firms engaged in the sale of standardized options register with the SEC as broker-dealers (see 15 U.S.C. 78c(a)(4) and (5)), and comply with record-keeping, reporting, confirmation, and financial responsibility requirements. All options issued by OCC are registered under both the Securities Act of 1933 and the Securities Exchange Act of 1934.[8] As required by the Securities Act of 1933, sales of such options are accompanied by the delivery of a prospectus (15 U.S.C. 77e(b)).

These features of contemporary options markets are of substantial relevance. In defining the term "security" to include any instrument "commonly known as" a security, Congress plainly indicated that the character given the instrument in our "commercial world" is entitled to great weight. Yet, the court of appeals virtually ignored the generally accepted understanding of the regulatory status of the $45 billion standardized options market.[9]

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[8] The definition of "security" in the two Acts is virtually the same. *E.g., United Housing Foundation, Inc.* v. *Forman, supra*, 421 U.S. at 847 n.12.

[9] The court may erroneously have assumed that its holding that an option on a GNMA security is not a security within the meaning of Section 3(a)(10) would not control the question of whether an option on an equity security is a "security" within the scope of that provision. For purposes of determining whether an option is a "security," however, there is no significant difference between the proposed GNMA options and options on equity securities. As to both, the option contract gives the purchaser either the right to purchase or the right to sell a specified quantity of securities at a stated price during the life of the option. OCC contemplated certain technical modifications in its clearing and settlement procedures (see Pet. App. D-6 to D-11), but trading in GNMA options would be sub-

c. The definitions of "security" contained in the Securities Act of 1933 and the Securities Exchange Act of 1934 embody "a flexible rather than a static principle." *Tcherepnin* v. *Knight*, *supra*, 389 U.S. at 338, quoting *SEC* v. *Howey Co.*, 328 U.S. 293, 299 (1946). Thus, the concept of a security includes instruments that did not even exist in 1934. See *SEC* v. *United Benefit Life Insurance Co.*, 387 U.S. 202 (1967); *SEC* v. *Variable Annuity Life Insurance Co.*, 359 U.S. 65 (1959) (both involving variable annuity contracts developed in the 1950s). Whether a particular instrument existed in 1934 or was specifically contemplated by the Seventy-Third Congress is immaterial. As this Court recently reiterated, the test is "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect." *SEC* v. *C. M. Joiner Corp.*, *supra*, 320 U.S. at 352-353; see *Marine Bank v. Weaver*, *supra*, slip op. 4-5. Applying that test here, the dissenting judge in the court below correctly concluded that GNMA options are "securities" within the meaning of the federal securities laws.

Until 1973, options on securities were sold only in the over-the-counter market. *Special Study of the Options Markets*, *supra*, at 73; 39th SEC Ann. Rep. 10 (1973); see generally 1 L. Loss, *Securities Regulation* 468 (2d ed. 1961). Most of the options trading was done in New York by a few broker-dealers. *Ibid.*; see generally *Stock Exchange Practices: Hearings on S. Res. 84, S. Res. 56 and S. Res. 97 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess., Pt. 15, 7062-7068 (1934) (hereinafter cited as "*1934 Senate Hearings*"); *Stock Exchange Regulation: Hearing on H.R. 7852, H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 457-464 (1934) (hereinafter

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stantially the same as trading in other listed options (see Pet. App. C-3, C-7 to C-12). See generally *Special Study of the Options Markets*, *supra*, at 73-75.

cited as "*1934 House Hearings*"). The terms of these option contracts were individually negotiated through broker-dealers, with a member of the NYSE guaranteeing performance. *Special Study of the Options Markets, supra*, at 73; 1 L. Loss, *Securities Regulation, supra*, at 468. The individualized terms of the contracts made secondary trading in these options both difficult and expensive, and, therefore, relatively limited. *Special Study of the Options Markets, supra*, at 73; 39th SEC Ann. Rep., *supra*, at 10.

The difference between these conventional over-the-counter options and today's standardized put and call options is substantial. See generally, *Special Study of the Options Markets, supra*, at 73-80. First, the terms of exchange-traded options are standardized; there is no face-to-face negotiation. Second, there is a liquid secondary market for such options; the options are of equivalent value to most persons. Third, "up-to-date quotations and transaction prices on listed options are obtainable, during the trading day, through quotation and price reporting services found in brokerage firms; and closing prices are available through newspapers." *Id.* at 73. Fourth, the options are registered under the Securities Act and the Securities Exchange Act, and all transactions are accompanied by delivery of a prospectus. Accordingly, whatever the status of the conventional over-the-counter options contracts traded in 1934,[10] exchange-traded stan-

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[10] Contrary to the reasoning of the court of appeals, Section 9 of the Securities Exchange Act of 1934, 15 U.S.C. 78i, provides no basis for concluding that the standardized options contemplated by the CBOE and OCC rule changes are not securities. Congress had uncovered widespread use of options to manipulate the securities markets, and Section 9(b) (15 U.S.C. 78i(b)) was intended to give the SEC plenary authority to prevent such manipulation. See, *e.g.*, S. Rep. No. 1455, 73d Cong., 2d Sess. 37, 43, 44-45 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 9, 17 (1934), H.R. Rep. No. 1383, 73d Cong., 2d Sess. 10-11, 21 (1934); see also *1934 Senate Hearings, supra*, at 6632 (statement of Richard Whitney, president of NYSE). Further, the distinction in Section 9(d) (15 U.S.C. 78i(d)) between registered warrants, rights, and convertible securities, on the one

dardized options today are perceived in our commercial world as securities, and dealt in as such. Compare *Marine Bank* v. *Weaver*, *supra*, slip op. 8-9. Indeed, more than two decades ago, Professor Loss observed that even conventional over-the-counter options contracts are "such an integral part of securities trading that it seems entirely reasonable to subsume them under the phrases 'investment contract' and * * * 'instrument commonly known as a security'." 1 L. Loss, *Securities Regulation* 469 (2d ed. 1961).

The holding of the court of appeals that standardized put and call options are not securities raises substantial questions as to the continuing validity of a number of aspects of the SEC's regulation of the options markets. While the SEC apparently would have authority under Section 9(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78i(b)) to regulate "puts" and "calls" on non-exempted securities, when such instruments are traded on a national securities exchange, other aspects of regulation which are premised upon the status of such options as separate securities presumably would be invalid. For example, it is doubtful whether the SEC could require the registration of such options under the Securities Act of 1933, as well as whether the margin rules promulgated by the Board of Governors of the Federal Reserve Board [11] and the insurance protections of the

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hand, and puts, calls, options, and straddles on the other, is based on the character of the instruments and the manner in which they were perceived and utilized in the commercial world of 1934. See *1934 Senate Hearings*, *supra*, at 6516-6517. That distinction is immaterial to the scope of the definition of the term "security" prescribed in Section 3 of the Act. Thus, while Section 9(b) was intended to augment the SEC's authority with respect to trading in options, the court of appeals has used it to curtail the SEC's authority in that area.

[11] Under Section 7 of the Securities Exchange Act of 1934 (15 U.S.C. 78g) the Board of Governors of the Federal Reserve System has authority to regulate "the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security)." The regulations of the Federal Reserve

Securities Investor Protection Corporation would continue to apply.

d. The "construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong * * *" (*Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969)). See, *e.g.*, *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978). This principle applies with particular force under the circumstances of this case. "[O]nce an agency's statutory construction has been 'fully brought to the attention of the public and the Congress,' and the latter has not sought to alter that interpretation although it has amended the statute in other respects, then presumably the legislative intent has been correctly discerned." *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979), quoting, *Apex Hosiery Co.* v. *Leader*, 310 U.S. 469, 489 (1940); see, *e.g.*, *CBS, Inc.* v. *FCC*, 453 U.S. 367, 382-385 (1981); *Haig* v. *Agee*, 453 U.S. 280, 299-301 (1981); see also *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, No. 80-203 (May 3, 1982), slip op. 27-28 & n.66. The inauguration of listed options trading and the registration of CBOE as a national securities exchange in 1973 was widely publicized. Trading in listed options expanded dramatically in the following years. See, *e.g.*, *Special Study of the Options Markets*, *supra*, at 1-3, 5; 43d SEC Ann. Rep. 12-15 (1977). In each of its annual reports since 1973, the SEC advised Congress of the status of listed options trading on the national securities exchanges.[12] And in August 1974, when CBOE was the only registered national securities exchange that listed and permitted trading of options on

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System are premised on the proposition that options on securities are separate securities within the meaning of the Act. See Pet. App. C-9 to C-10.

[12] See 47th SEC Ann. Rep., *supra*, at 4-5; 46th SEC Ann. Rep. 4-6 (1980); 45th SEC Ann. Rep. 5-6 (1979); 44th SEC Ann. Rep. 6-7, 10 (1978); 43d SEC Ann. Rep. 12-15 (1977); 42d SEC Ann. Rep. 17-18 (1976); 41st SEC Ann. Rep. 15-16 (1975); 40th SEC Ann. Rep. 8-9 (1974); 39th SEC Ann. Rep. 10-11 (1973).

securities, Congress specifically acknowledged that exchange-traded options were regulated by the SEC. See S. Rep. No. 93-1131, 93d Cong., 2d Sess. 26 (1974) ("Where traded on exchanges, these puts and calls are regulated by the Securities and Exchange Commission").

The following year, Congress enacted the Securities Act Amendments of 1975, Pub. L. No. 94-29, 89th Stat. 97, which constitute Congress' "most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934."[18] By the time the 1975 Amendments were enacted, the SEC had authorized listed options trading on the CBOE, Amex, and Phlx. See 42d SEC Ann. Rep., *supra*, at 17. At no point in this process of comprehensive review and revision did Congress express the slightest doubt that the SEC properly had asserted jurisdiction over options traded on these securities exchanges. Indeed, in discussing the SEC's broad new powers to oversee the development of a national market system, the Senate Banking Committee explained: "[t]he term 'national market system' as used in the bill would encompass all segments of the corporate securities markets including all types of common and preferred stocks, bonds, debentures, warrants *and options*." S. Rep. No. 94-75, 94th Cong., 1st Sess. 7 (1975) (emphasis added).

e. As we have demonstrated above, the holding of the court of appeals is inconsistent with the language of the Securities Exchange Act and disregards commercial practice as well as congressional ratification of the SEC's construction of the securities laws over the past decade. The holding of the court also is inconsistent with a substantial body of judicial authority. Indeed, until the decision of the court below, the status of options on securities as "securities" was well settled. In *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1026 n.40 (6th Cir. 1979), the court of appeals explained:

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[18] *Securities Acts Amendments of 1975: Hearings on S. 249 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess. 1 (1975).

> The definition of 'security' in § 3 of the Securities Exchange Act expressly includes 'any * * * warrant or right to subscribe to or purchase any' 'stock'. 15 U.S.C. § 78c(a)(10). This clearly includes options to purchase or sell stock.

See also *Lutgert* v. *Vanderbilt Bank*, 508 F.2d 1035, 1038 (5th Cir. 1975). The district courts also have agreed with virtual unanimity that options on securities are separate securities.[14]

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[14] See, *e.g.*, *In re McDonnell Douglas Corp. Securities Litigation* [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,737, at 93,723 (E.D. Mo. June 22, 1982); *Backman* v. *Polaroid Corp.*, 540 F. Supp. 667, 671 (D. Mass. 1982) ("Call options are securities within the meaning of Section 10(b) * * *."); *O'Connor & Associates* v. *Dean Witter Reynolds, Inc.*, 529 F. Supp. 1179, 1186 (S.D.N.Y. 1981); *Savino* v. *E.F. Hutton & Co.*, 507 F. Supp. 1225, 1235 (S.D.N.Y. 1981) ("the * * * stock options that defendants purchased and sold * * * undoubtedly constituted 'securities.'"); *Lloyd* v. *Industrial Bio-Test Laboratories, Inc.*, 454 F. Supp. 807, 822 (S.D.N.Y. 1978) ("Calls have been explicitly and implicitly recognized as securities"); *Lubin* v. *Belco Petroleum Corp.*, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,543, at 94,237 (S.D.N.Y. Aug. 24, 1978) ("An option to buy or sell a security involves investment risks paralleling those entailed in ownership of the underlying security and is thus a security itself."); *Piemonte* v. *Chicago Board Options Exchange, Inc.*, 405 F. Supp. 711 (S.D.N.Y. 1975) (recognizing that standardized options traded on the CBOE are separate securities subject to separate registration and investor disclosure requirements under the securities laws); *Vogel-Lorber, Inc.* v. *Options on Shares, Inc.*, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,911, at 97,109 (S.D.N.Y. Dec. 9, 1974) ("it is apparent that the SEC intended that options be considered as securities * * *."); *Globus, Inc.* v. *Jaroff*, 271 F. Supp. 378, 380 (S.D.N.Y. 1967) ("It is axiomatic that * * * an option agreement is a security under the 1934 Act * * *"); *SEC* v. *Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 292 (S.D.N.Y. 1966), rev'd in part on other grounds, 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969) ("A stock option is a security * * *."). But see, *LTV Federal Credit Union* v. *UMIC Government Securities, Inc.*, 523 F. Supp. 819 (N.D. Tex. 1981) (holding that a GNMA standby commitment is not a security).

2. As an alternative basis for its ruling, the court of appeals held that options on GNMA securities are within the exclusive jurisdiction of the CFTC because they "involv[e]" futures contracts on GNMA securities. Resolution of that question also is critical to the nation's financial markets. The court's decision dictates which of two alternative, and in some respects significantly divergent, regulatory schemes will govern the trading of GNMA options. It also can be expected to affect the allocation among markets of a broad range of proposed new options products.[15] Moreover, the court's broad construction of the word "involve" in the so-called "Treasury exclusion" sweeps within the scope of the Commodity Exchange Act a host of transactions Congress clearly intended to exclude.

a. Until recently, the only "commodities" subject to regulation under the Commodity Exchange Act were a few specifically designated agricultural products set out in Section 2 of that Act (7 U.S.C. (1970 ed.) 2). In 1974, Congress expanded and generalized the definition of "commodity" to include the articles listed and "all other goods and articles, except onions * * *, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in * * *." Section 201, Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1596, 7 U.S.C. (Supp. IV) 2.

Congress recognized that the expanded definition of the term commodity was sufficiently broad to include instruments that also are securities under the federal securities laws and within the SEC's jurisdiction. To avoid a

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[15] For example, the SEC has approved changes in the rules of CBOE and Amex that would permit listing and trading of options on United States Treasury bonds, notes, and bills. See *Securities Exchange Act* Rel. No. 18370 (Dec. 23, 1981), 24 SEC Docket 464 (Jan. 5, 1982). CBOT and the Chicago Mercantile Exchange have petitioned for review of the SEC order, arguing that options on those securities also are within the CFTC's exclusive jurisdiction and not otherwise subject to SEC regulation. That review proceeding (No. 82-1097) is now pending in the Seventh Circuit.

potential regulatory conflict, Congress added two provisos to the new definition (Pub. L. No. 93-463, Section 201(b), 88 Stat. 1395; emphasis added):

> [1] *Provided*, That the [CFTC] shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions *involving contracts of sale of a commodity for future delivery* traded or executed on a contract market * * * or any other board of trade, exchange, or market * * * [;] *And* [2] *provided further*, That, *except as hereinabove provided, nothing contained in this section shall* (i) *supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission* or other regulatory authorities under the laws of the United States or of any State, *or* (ii) *restrict the Securities and Exchange Commission* and such other authorities *from carrying out their duties and responsibilities in accordance with such laws.*[16]

The court of appeals correctly concluded that the CFTC has jurisdiction to regulate trading in options on securities only if such trading is within the scope of the exclusive jurisdiction proviso.[17] Accordingly, the restric-

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[16] In Section 402 of the Commodity Futures Trading Commission Act of 1974, Congress authorized the CFTC to regulate options "involving any commodity." Pub. L. No. 93-463, 88 Stat. 1412, 7 U.S.C. (Supp. IV) 6c(b). In 1978, Congress generally banned trading in options "involving any commodity," pending prescribed action by the CFTC. Section 3, Futures Trading Act of 1978, 92 Stat. 867, 7 U.S.C. (Supp. IV) 6c(c).

[17] As the court of appeals explained (Pet. App. A-16 to A-17 & n.16) the phrase "except as hereinabove provided," which introduces the second proviso, refers only to the immediately preceding clause establishing the CFTC's exclusive jurisdiction. See, *e.g.*, H.R. Rep. No. 93-975, 93d Cong., 2d Sess. 28 (1974) ("except as to transactions covered by the first proviso, the expanded definition of commodity is not intended to der[]ogate from the jurisdiction

tions on commodity options trading in Section 4c of the Commodity Exchange Act (7 U.S.C. (Supp. IV) 6c) do not preclude SEC approval of trading in GNMA options on the CBOE unless GNMA options are within the CFTC's exclusive jurisdiction. See Pet. App. A-16 to A-17 & n.16.

In Section 2(a)(1) of the Commodity Exchange Act (7 U.S.C. (Supp. IV) 2), the phrase "contracts of sale of a commodity for future delivery" refers to futures contracts and not options.[18] Therefore, unless GNMA options "involv[e]" GNMA futures contracts, the CFTC does not have exclusive jurisdiction over such instruments. The court held that GNMA options "involve" GNMA futures. But it offered no explanation of how an option on a security "involves" a futures contract on that security, in any sense that Congress conceivably could have intended. Indeed, the court concedes (Pet. App. A-21) that not all options on securities "involv[e]" futures contracts on those securities. According to the court (Pet. App. A-27 to A-32), options on "non-traditional" securities like GNMA securities involve GNMA futures, but options on "traditional" securities like corporate equity and debt

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of the Securities and Exchange Commission * * *"); S. Rep. No. 93-1131, 93d Cong., 2d Sess. 23 (1974). Thus, the SEC's jurisdiction to regulate trading in securities is unaffected by the expanded scope of the term "commodity," except "with respect to accounts, agreements (including * * * option[s]), and transactions involving contracts of sale of a commodity for future delivery."

[18] Unlike an option, a futures contract is an executory sales contract, involving a promise to deliver and a promise to take delivery and make payment at some time after the contract is formed. See generally Greenstone, *"The CFTC and Government Reorganization: Preserving Regulatory Independence,"* 33 Bus. Law 164, 168-170 (1977); H.R. Rep. No. 93-975, *supra*, at 130. An option is an irrevocable offer to buy ("put" option) or sell ("call" option) at a specified price during the life of the option; the purchaser of an option acquires either the right to buy the underlying goods from the option seller or the right to sell the underlying goods to the option seller.

securities might not involve futures on those instruments.

There is no substantial basis for such an artificial and illogical distinction. The meaning of the term "involve" does not change depending on the nature of the underlying commodity. We submit that Congress intended a much simpler and more straightforward distinction. The CFTC's exclusive jurisdiction over securities-related instruments extends only to: (1) contracts for the sale of a commodity for future delivery (*i.e.*, futures contracts) and (2) options, including "privilege[s]," "indemnit-[ies]," "bid[s]," "offer[s]," "put[s]," "call[s]," "advance guarant[ees]," and "decline guarant[ees]," on futures contracts. See H.R. Conf. Rep. No. 93-1383, 93d Cong., 2d Sess. 35-36 (1974).[19] With these exceptions, jurisdiction over instruments relating to securities, including trading in options on securities, was to remain with the SEC. See H.R. Rep. No. 93-975, *supra*, at 7-8, 28, 57; S. Rep. No. 93-1131, *supra*, at 6, 23, 26, 41-42. As Congress clearly stated: "[T]he [CFTC] would not have the authority to regulate trading in puts and calls for securities. Where traded on exchanges, these puts and calls are regulated by the Securities and Exchange Commission." *Id.* at 26.

The court of appeals' interpretation of the relevant statutory language to encompass options on securities not only contravenes the intent of Congress, but also disregards the ordinary meaning of the term "involve." The

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[19] Historically, Congress has used the terms "privilege," "indemnity," "bid," "offer," "put," "call," "advance guaranty," and "decline guaranty" in the futures trading context to refer to forms of options on futures contracts. See, *e.g.*, Section 3, The Future Trading Act, ch. 86, 42 Stat. 187 (imposing a prohibitive tax on "each and every privilege or option for a [futures] contract * * * intending * * * to tax only the transactions known to the trade as 'privileges,' 'bids,' 'offers,' 'puts and calls,' 'indemnities,' or 'ups and downs.' "); 80 Cong. Rec. 8088-8089 (1936) (defining the terms, as they were generally understood in the trade); see also S. Rep. No. 871, 67th Cong., 2d Sess. 1 (1922) (noting the technical meaning of the term "options," as used in commodity trading).

word "involv[e]" denotes a close relationship. The only relationship between GNMA options and GNMA futures even suggested by the court of appeals is that (Pet. App. A-29 to A-30) "both instruments are claimed to serve more or less the same purposes, and the prices in each market assumedly would affect one another." Many contracts "more or less" serve the function of shifting risks. There is necessarily a relationship between the prices in options and futures since they both are based on the price of the underlying good. However, there also is a relationship between futures transactions and transactions in the underlying good, but the CFTC's exclusive jurisdiction plainly does not extend to the regulation of transactions in the underlying cash market. Thus, while an option on a futures contract "involves" a futures contract, an option on the underlying commodity clearly does not. The CFTC's exclusive jurisdiction extends only to the former instrument. See Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*," 29 Vand. L. Rev. 1, 15 n.45 (1976).

b. The court of appeals adopted a similarly broad and untenable construction of the word "involve" in a separate provision of Section 2(a)(1) of the Commodity Exchange Act, generally referred to as the "Treasury exclusion." That provision reads as follows (7 U.S.C. (Supp. IV) 2):

> Nothing in this [Act] shall be deemed to govern or in any way be applicable to transactions in foreign currency, *security warrants*, *security rights*, resales of installment loan contracts, repurchase options, *government securities*, or mortgages and mortgage purchase commitments, *unless such transactions involve the sale thereof for future delivery conducted on a board of trade.*[20]

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[20] The provision is referred to as the "Treasury exclusion" because it was initially drafted and submitted as a proposed amendment by the Department of Treasury. See S. Rep. No. 93-1131, *supra*, at 49-51.

The court acknowledged (Pet. App. A-35) that an option to purchase securities (a "call" option) "might be" within the phrase "security rights."[21] Nonetheless, the court concluded (Pet. App. A-36) that, even if GNMA options were instruments specifically enumerated in the Treasury exclusion, the phrase "unless such transactions involve the sale thereof for future delivery conducted on a board of trade" would apply because "GNMA options 'involve' GNMA futures contracts."

This unreasonably broad interpretation of the word "involve" essentially reads part of the Treasury exclusion out of the Act. If GNMA options "involve" GNMA futures, then all "security warrants" and "security rights" presumably would "involve" futures contracts on the underlying security, and Congress' intent to make clear that the Commodity Exchange Act does not apply to transactions in such instruments would be frustrated. The legislative history of the provision only confirms what the language makes plain. "[T]he provisions of the bill are not applicable to trading in foreign currencies and certain enumerated financial instruments [including security rights] *unless such trading is conducted on a formally organized futures exchange.*" S. Rep. No. 93-1131, *supra*, at 23 (emphasis added). As already noted, Congress recognized that CFTC regulation of transactions in options was wholly "unnecessary" (S.

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[21] As proposed by the Department of Treasury, the provision also excluded transactions in "puts and calls for securities" from the scope of the Commodity Exchange Act. The court of appeals cited (Pet. App. A-35 & n.32) Congress' failure to include this phrase as evidence that options transactions are not transactions in security rights. The court's reliance on the omission is misplaced. Since the general phrase "security rights" is plainly broad enough to include options, the phrase "puts and calls for securities" was deemed redundant. As already observed, Congress' intention was that the CFTC "would not have the authority to regulate trading in puts and calls for securities." S. Rep. No. 93-1131, *supra*, at 26. The SEC and bank regulatory agencies maintained their established jurisdiction in that area. *Ibid.*

Rep. No. 93-1131, *supra*, at 23) because: "[w]here traded on exchanges, these puts and calls are regulated by the Securities and Exchange Commission." *Id.* at 26.

CONCLUSION

The petition for a writ of certiorari should be granted.[22]

Respectfully submitted.

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[22] If Congress enacts legislation superseding the decision of the court of appeals (see note 5, *supra*), the Court should vacate the judgments of the court of appeals in these cases and remand for consideration of mootness. We will, of course, apprise the Court of any significant legislative developments.

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